ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Portantino	Analyst:	Jahna Alvarado	Bill Number:	AB 11
Related Bills:	See Legislative History	Telephone:	845-5683	Introduced Date:	December 6, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Workers Compensation Premium Credit/Reduce Cap On New Jobs Credit

SUMMARY

This bill would do the following:

- Create an income tax credit for a portion of the worker's compensation premiums (WCP) paid by a qualified taxpayer, as defined, limited to a cumulative total of WCP credit of $200 million dollars; and
- Reduce the cumulative total of existing new job credits from $400 million to $200 million.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide immediate relief to small businesses struggling in the current economic climate via an income tax credit.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be immediately effective upon enactment. The WCP credit would be specifically operative for taxable years beginning on or after January 1, 2011, and would be repealed by its own terms on December 1 of the year after the year in which the allowable WCP credit limit is reached. The reduction to the cumulative limit for the existing new jobs credit would be operative for all taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

Workers' compensation laws are designed to ensure that employees who are injured or disabled on the job are provided with fixed monetary awards, eliminating the need for litigation. These laws also provide benefits for dependents of those workers who are killed because of work-related accidents or illnesses. Some laws also protect employers and fellow workers by limiting the amount an injured employee can recover from an employer and by eliminating the liability of co-workers in most accidents. State workers' compensation statutes establish this framework for most employment.

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FEDERAL/STATE LAW

Federal statutes are limited to federal employees or those workers employed in some significant aspect of interstate commerce.

California state law requires all employers to purchase or provide workers' compensation benefits for their California employees. Employers may finance their liability for workers' compensation benefits by one of three methods: (1) self-insurance, (2) private insurance, or (3) state insurance. Employers wishing to self-insure must first obtain consent from the Department of Industrial Relations (DIR). Only certain aspects of workers' compensation are administered by a government agency.

- Under the DIR, the Division of Workers' Compensation (DWC) monitors the administration of workers' compensation claims and manages the exclusive judicial system in which the claims are resolved or adjudicated.
- Under the DIR, the Office of Self Insurance Plans (SIP) authorizes qualified employers to provide their own coverage for workers' compensation liabilities. The SIP is responsible for certification of public and private self-insured employers, third-party administrative agencies that oversee self-insurance programs, and individual claims adjusters. Self-insurers are required to post a security deposit, which is adjusted annually to cover liabilities incurred. Self-insurers must also submit to SIP audits.
- The Department of Insurance licenses over 180 private insurance companies transacting a workers' compensation insurance business in California.[1] The individual insurance companies set the insurance rates that vary depending on a variety of factors.
- The State Compensation Insurance Fund (SCIF) is a non-profit, public enterprise that operates similar to a mutual insurance carrier. Unlike other carriers, the SCIF exists solely for the benefit of California employers. Workers' compensation insurance may be purchased directly from the SCIF. The Workers' Compensation Insurance Rating Bureau determines the SCIF's rates.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Neither state nor federal law allows a tax credit similar to the one proposed by this bill.

[1] A current listing of licensed workers compensation insurance companies can be accessed at http://interactive.web.insurance.ca.gov/webuser/ncdw_alpha_co_line$.startup

THIS BILL

For taxable years beginning on or after January 1, 2011, this bill would establish an income tax credit in an amount equal to 20 percent of the total amount of the annual workers' compensation premiums paid by a qualified taxpayer during the taxable year. Any credits not used in the taxable year may be carried forward up to nine years.

A "qualified taxpayer" would be defined as a taxpayer that meets both of the following criteria:

1. Has gross receipts less returns and allowances reportable to the state for the taxable year of $1 million or less, and
2. With the exception of a taxpayer who first commences doing business in the state during the taxable year, employs 20 or fewer employees as of the last day of the preceding taxable year.

The determination of "commencing doing business" within the state would be made by reference to the new business qualifications contained in the existing net operating loss provisions regarding "new businesses."

The credit that would be allowed by this bill would be exclusive of any other deduction or credit otherwise allowed for workers compensation premiums.

Taxpayers may only claim the WCP credit on an original timely filed return received by the Franchise Tax Board (FTB) on or before a cutoff date specified by the FTB. The cutoff date would be the last day of the calendar quarter within which the FTB estimates it will have received timely filed original returns claiming the credit that cumulatively totals $200 million for all taxable years. The date a return is received would be determined by the FTB. Determinations made by the FTB with respect to the cut-off date, the date a return is received, and whether a return has been timely filed may not be reviewed in any administrative or judicial proceeding.

Additionally, any disallowance of the WCP credit due to the cumulative total of the WCP credit being reached would be treated as a math error and would not be subject to review in any administrative or judicial proceeding.

The FTB would provide periodic notice on its Web site of the amount of the WCP credit claimed on timely filed original returns and may prescribe, subject to the provisions of the Administrative Procedures Act (APA), rules, guidelines, or procedures necessary to carry out these provisions.

The WCP credit would remain in effect until December 1 of the calendar year after the year in which the cumulative WCP credit limit has been reached and would be repealed as of that date.

This bill would reduce the cumulative limit on the new jobs tax credit from a total of $400 million, of which, approximately $40 million has been allocated to date, to $200 million.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

It is unclear whether the term "gross receipts less returns and allowances reportable to the state" would be based on a taxpayer's worldwide income or would be limited to income attributable to California. In order to avoid disputes between taxpayers and the department, it is suggested that this term be amended for clarity.

This bill uses the undefined term "annual workers' compensation premiums." Specifying what would be considered annual workers' compensation premiums would prevent disputes between taxpayers and the department. For example, would amounts paid for premiums or benefits for employees working outside of California be included? Would amounts paid by self-insured taxpayers be included? Would non-cash items, such as bonds, or pledged lines of credit used by a self-insured taxpayer, be included?

A taxpayer, including any related parties, doing business within the state would be limited to 20 or fewer employees to be eligible for the WCP credit, while a taxpayer that commences doing business within California during the taxable year could have an unlimited number of employees and could be eligible for the WCP credit for that taxable year. If this is inconsistent with the author's intention, this bill should be amended.

It is unclear how the determination of 20 or fewer employees would be calculated. For example, would this be a strict head count with a part-time employee and a full-time employee counting equally? Also, because the determination of the number of employees for a taxpayer that is doing business within the state is done as of a specified date, it is possible that a taxpayer could reduce their workforce to reach the employee limitation required to qualify for the WCP credit and rehire the employees the day after the specified date. The author may wish to amend this bill to clarify the meaning and calculation of "20 or fewer employees" to avoid disputes between taxpayers and the department.

A taxpayer that had the WCP credit disallowed because the $200 million cumulative WCP credit had been reached would be subject to underpayment penalties. If it is the author's intention that underpayment penalties would be inapplicable in this situation, this bill should be amended.

Compliance with the provisions of the APA regarding regulations could affect the FTB's ability to implement the WCP credit. If it is the author's intention to provide immediate relief for qualified taxpayers, as defined, the author may wish to amend this bill to provide an APA exemption similar to the exemption provided for the new jobs credit that the WCP credit is patterned after.

TECHNICAL CONSIDERATIONS

Due to recently enacted legislation that renumbered the relevant code sections, this bill needs to be amended where the language refers to Revenue and Taxation Code (R&TC) section 17276, as the correct reference is currently R&TC section 17276.20 in the personal income tax law, and R&TC section 24416.20 in the corporation tax law.

LEGISLATIVE HISTORY

SB 375 (Margett, 2003/2004) would have established a credit equal to 50 percent of the amount paid by a taxpayer for workers' compensation during the taxable year. SB 375 failed to pass out of the Senate Appropriations Committee by the constitutional deadline.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states do not offer a credit similar to the credit proposed in this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

This bill would require a calculation for the WCP credit that would require a new form or worksheet to be developed and could result in several existing forms expanding from 2 to 3 pages. Additionally, the WCP credit would require additional information to be keyed, monitored, and reported. As a result, this bill would impact the department's printing, processing and storage costs for tax returns. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 11
For Taxable Years Beginning On or After January 1, 2011
Enactment Assumed After June 30, 2011
($ in Millions)

	2011-12	2012-13	2013-14	2014-15	2015-16
Job Tax Credit	$155	$21	$10	$ 8	$6
WCP Credit	-$130	-$35	-$16	-$10	-$7
Total	$25	-$14	-$6	-$2	-$1

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

POLICY CONCERNS

This bill would allow tax credits for expenditures for workers' compensation premium expenses that are required by existing state and federal laws or regulations. Generally, a credit is used as an incentive for future behavior rather than a reward for complying with required behavior.

Generally, a credit is used as an incentive for behavior that occurs within the state. To the extent that the WCP credit is based on workers' compensation premiums paid to insure workers that perform their services outside of California, this credit would benefit behavior that occurs outside the state. This may be contrary to the author's intention.

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